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SUBJECT: KAZAKHSTAN: WORLD BANK OFFICIALS DISCUSS ECONOMIC
SITUATION, EFFECTS OF CURRENCY DEVALUATION

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: The Ambassador had an introductory meeting with incoming World Bank Country Director for Central Asia Motoo Konishi on February 24. Konishi and World Bank Country Manager for Kazakhstan Sergei Shatalov explained that the February 4 devaluation of the tenge should have a positive impact on Kazakhstan's balance of payments. Shatalov said that foreign direct investment in Kazakhstan is likely to decline as a result of the global economic crisis. The World Bank officials expected a one-time spike in consumer prices as a result of the tenge's devaluation and said it is too early to tell whether there will have to be a further devaluation. Konishi said that Prime Minister Masimov needs to take on entrenched interests in dealing with the financial crisis. The World Bank officials argued that Kazakhstan has to focus in the long-run on developing its human capital. Shatalov explained that the Bota Foundation should be ready to disburse money this summer. He asked for our assistance in obtaining the U.S. Department of Justice's concurrence that Kazakhstan's progress on certain transparency-related initiatives is sufficient to enable Bota to move forward. END SUMMARY.

CURRENCY DEVALUATION IMPROVES BALANCE OF PAYMENTS

13. (SBU) The Ambassador had an introductory meeting on February 24 with incoming World Bank Country Manager for Central Asia Motoo Konishi, who is replacing Annette Dixon. Konishi and World Bank Country Manager for Kazakhstan Sergei Shatalov told the Ambassador that the February 4 devaluation of the tenge would likely have a positive impact on Kazakhstan's balance of payments. Shatalov explained that according to models run by the Bank, with a \$40 per barrel price for crude, Kazakhstan's balance of payments deficit at the new exchange of around 150 tenge per dollar should be in the range of \$4 billion. By comparison, at the old exchange rate of around 120 tenge per dollar, the deficit would have been in the \$15 billion range. The \$4 billion deficit could be further reduced by constraining imports, with any remainder handled through management of currency reserves.

FDI LIKELY TO DECLINE

14. (SBU) Shatalov said that foreign direct investment (FDI) in Kazakhstan, especially in the energy sector, is likely to decline as a result of the global financial crisis. He said specifically that Lukoil is planning to scale back its investments, which could impact expansion of the Karachaganak project. Shatalov further claimed that there are rumors that first oil from Kashagan might be pushed out yet again, perhaps to 2015. (NOTE: We have not heard anything from U.S. companies -- ExxonMobil, Chevron, and ConocoPhillips -- about any plans that they might have to scale back their own investments, nor have we heard anything concrete about a new Kashagan delay. END NOTE.) In any event, reduced FDI might help the country's balance of payments situation further, because FDI, particularly in the energy sector, leads to imports of machinery and other goods, Shatalov pointed out.

ONE-TIME SPIKE IN INFLATION

15. (SBU) Shatalov said that the World Bank expects a one-time spike in Kazakhstan's consumer price index as a result of the tenge's devaluation, but they do not believe the devaluation will have a continuing impact on the inflation rate. The World Bank officials indicated it is too early to tell whether there will have to be a further devaluation of the tenge. The National Bank releases only monthly -- rather than weekly -- figures on its currency reserves, and is slow to release even those figures, so we will not know until several days into March whether the National Bank stemmed its losses of reserves with the devaluation. Shatalov noted that 12-month tenge futures are trading at 240 tenge to the dollar, but the World Bank officials indicated that this futures' market is open to speculation and manipulation, and thus we should not make too much

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of this figure. The World Bank officials confirmed that despite budget pressures, the government is trying to maintain spending on social programs. They noted that the Kazakhstanis had not been able to implement a distressed assets fund to buy up bad assets from commercial banks because, after discussions with the World Bank, the Kazakhstanis realized how difficult it would be to properly value such assets. As Konishi put it, "How do you value these assets when there is no market for them?" According to Shatalov, significant increases in credit default swap (CDS) rates indicate that the markets believe that both Halyk Bank and KazKommertsBank are in trouble.

MASIMOV WOULD BE DIFFICULT TO REPLACE

16. (SBU) Noting rumors that Prime Minister Masimov might be removed and made a scapegoat for the economic situation, Shatalov said Masimov has proven himself a skilled economist, diplomat, and interlocutor with international institutions who would be difficult to replace. (NOTE: Rumors about Masimov's impending demise essentially date from the first day he was appointed prime minister.

We agree with Shatalov that it doesn't make sense to replace him given how adept he is at dealing with complex economic and financial issues -- but that doesn't make his position invulnerable. END NOTE.) Konishi said that to tackle the financial crisis, Masimov needs to take on entrenched interests and limit the flow of resources directed toward favored insiders, which might lead to growing pressures against him. He pointed to the recent criminal proceedings launched against the prominent KUAT construction company as indicative of the government's desire to preserve resources, and where possible, recoup losses.

HUMAN CAPITAL SHOULD BE LONG-TERM FOCUS

17. (SBU) The World Bank officials explained that Kazakhstan should be focusing not only on the immediate financial crisis, but also on developing policies to ensure Kazakhstan's economic success in a post-crisis world. Konishi said that over the long-run, Kazakhstan must broadly develop its human capital, including through investments in education and health care. Shatalov noted that the World Bank is providing assistance to the Ministry of Education in its effort to open a world-class, showcase university in Astana, which is currently under construction.

NEXT STEPS ON THE BOTA FOUNDATION

18. (SBU) Shatalov also provided an update on the progress of the Bota Foundation. He said the initiative enjoys the full support of the Kazakhstani government. Bota has set up its team, and now has a representational office in Almaty with twelve program officers. The Foundation would like to start disbursing money during the summer, but according to the 2006 MOU, the World Bank first needs the U.S. Department of Justice's concurrence that Kazakhstan has made sufficient progress on certain transparency-related initiatives, including the Extractive Industries Transparency Initiative (EITI) and the Public Finance Management Review. Shatalov explained that during a recent meeting, State Secretary Kanat Saudabayev criticized the World Bank for dragging its feet on Bota. He asked for our assistance in getting the green light from the Department of Justice. Shatalov said that he would be in Washington March 22-29, and requested a meeting with the State Department to discuss a way forward.

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